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Africa Review

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Articles

Eastern and Southern African Preferential Trade Area: In Pursuit of Economic Cooperation

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The Eastern and Southern African Preferential Trade Area (PTA) organization is scheduled to meet this month in Lusaka, providing an opportunity for members to review the achievements of the fledgling institution and to chart a course for increased economic cooperation. The 15-nation PTA, however, faces major obstacles to achieving effective regional economic integration.

Achievements to Date

The PTA has focused primarily on reducing tariffs on items traded between members. The PTA countries accepted in July 1984 a common list of 212 traded items with programed tariff reductions of between 10 and 70 percent by mid-1986. The reductions for broad product categories include:

	Percent
Food, excluding luxury goods	30
Agricultural raw materials	50
Nonagricultural raw materials	60
Durable consumer goods	30
Capital goods	70

At least 25 percent of a traded item must have originated in the exporting PTA country to be eligible for the tariff benefits. The item must also have been processed by a firm that is at least 51 percent domestically owned.

The PTA also has taken other measures to promote freer trade. As an initial step in removing nontariff barriers, PTA countries have agreed since July 1984 that goods shipped between two member states may transit a third PTA country unhindered. In an effort to facilitate settlement of trade payments in local currency instead of scarce foreign exchange, the PTA established a clearinghouse, run by the Zimbabwe Reserve Bank, in February 1984. 25X1

Background of the Preferential Trade Area

The PTA is an organization of 15 countries with headquarters in Lusaka. Launched in 1982, it aims to promote cooperation among its members in trade, industry, agriculture, communications, natural resources, and monetary affairs. An additional five countries are eligible for membership, but have not yet joined. Founded with the encouragement of the Organization for African Unity (OAU) and the United Nations Economic Commission for Africa (ECA), the PTA is a counterpart of the 16-member Economic Community of West African States (ECOWAS) and a further step toward the long-term objective of an African common market. 25X1

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Current Agenda

The PTA, in our view, presently faces several issues that are probably critical to the organization's future prospects:

- Persuading eligible countries—Angola, Botswana, Madagascar, Mozambique, and Seychelles—to join. Most of these countries have little trade with PTA members and probably see little reason to become members. 25X1

PTA Countries: Selected Trade Data, 1984

Million US $

	Exports (f.o.b.)		Imports (c.i.f.)	
	World	PTA Countries	World	PTA Countries
Present PTA members				
Burundi	98	6	186	20
Comoros	9	NEGL	36	2
Djibouti	39	14	303	41
Ethiopia	397	17	917	4
Kenya	1,228	199	1,679	21
Lesotho	NA	NA	NA	NA
Malawi	252	22	158	33
Mauritius	357	3	448	14
Rwanda	143	7	203	54
Somalia	123	1	413	19
Swaziland	307 [a]	NA	497 [a]	NA
Tanzania	456	20	914	19
Uganda	395	2	324	127
Zambia	844	39	549	47
Zimbabwe	792	57	761	35
Nonmembers eligible to join				
Angola	2,258	0	1,003	1
Botswana	674	NA	679	NA
Madagascar	384	1	483	1
Mozambique	185	25	532	43
Seychelles	26	0	87	11

[a] 1983 data.

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- Acting on a proposal to reduce the minimum level of local ownership for firms to benefit from preferential tariffs from 51 to 30 percent. Lobbying efforts by business groups that include firms with majority foreign ownership or are foreign subsidiaries have been supported by several PTA countries who want to encourage foreign investment in promoting production and exports.

- Establishing the terms of reference for a proposed PTA Trade and Development Bank to be located in Bujumbura, Burundi. The bank will assume the PTA clearinghouse functions currently performed by Zimbabwe and will finance trade between PTA members.

- Assessing the implementation of the 1984-86 program for lowering tariffs and developing a framework for the continued reduction of nontariff barriers.

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Despite some disagreement, we do not believe any issue will cause a major division among PTA members. For example, PTA countries can do little to alter the reluctance of potential PTA countries toward membership. Also, Marxist Ethiopia discourages foreign investment and is reportedly opposed to the PTA proposal to lower the degree of local ownership of firms qualifying for preferential tariff treatment.

We do not expect Addis Ababa to implement the proposal even if it is ratified. For most major issues, all PTA countries probably stand to benefit from more cooperative actions. [redacted]

The PTA Authority (heads of state and government) and the PTA Council of Ministers are the two highest PTA organs and retain major decisionmaking authority. In keeping with past practices, however, we expect the bulk of the decisions to be made by the Council of Ministers, acting on instructions from home governments. Several heads of state have been absent from previous annual summit meetings, and only four showed up last year. [redacted]

Potential Problems

We believe that several substantial obstacles lie in the path of the infant PTA:

- Political instability will continue to hamper efforts at economic cooperation. Insurgencies and ethnic cleavages in Angola, Ethiopia, Mozambique, Somalia, and Uganda restrict governmental authority and undermine economic development.

- Disparate levels of industrial development contribute to varying degrees of support for the PTA. According to US Embassy reporting, Kenya and Zimbabwe, the more highly industrialized countries in the group, have traditionally had trade surpluses with most other PTA countries and see the PTA as a means of expanding their industrial base for a growing market. [redacted] other PTA members see few advantages to membership because they have little to sell to other member countries and run trade deficits with Kenya or Zimbabwe. [redacted]

- According to US Embassy reporting, most PTA members prefer export sales to external markets to earn foreign exchange over sales to PTA countries that generate payments in domestic currency. This practice clearly undermines the prospects of growing PTA trade, in our view. [redacted] 25X1 25X1

Relationship to the SADCC

The PTA objectives overlap those of an older regional cooperation organization set up in 1979, the Southern African Development Coordination Conference (SADCC), which is made up of nine actual or potential PTA members—Angola, Botswana, Lesotho, Malawi, Mozambique, Swaziland, Tanzania, Zambia, and Zimbabwe. Founded on the initiative of Tanzania's Nyerere, the SADCC is also committed to regional cooperation and reducing economic dependence on South Africa. Unlike the PTA, the SADCC does not explicitly have a program for trade cooperation, although it has mechanisms for coordination in other areas of regional economic activity. In view of the precedent of members of a wider regional organization participating in smaller groupings—ECOWAS countries are members of the larger OAU, for example—we do not expect significant conflict between the two groups. [redacted] 25X1 25X1

Outlook

ECOWAS' example of slow progress toward economic integration over the past 10 years does not augur well for the PTA. The major disparities among members in political ideology, industrial development, and political stability will remain obstacles to rapid progress. We expect that the PTA will pursue gradual integration measures with an eye to avoiding actions and issues that would cause the organization to split apart. [redacted] 25X1 25X1 25X1 25X1 25X1

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Zaire: Dim Prospects for Growth

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We believe Zaire will experience slow economic growth through the end of the decade and a continuation of the 10-year decline in per capita real GNP. Zaire's hopes for more rapid growth rest on its ability to boost exports and remove the foreign exchange constraint on essential imports. We foresee, however, only modest export growth that, when combined with growing debt service obligations and little new external capital, will constrain real import growth to an average of only 2 percent per year. Import growth at this low rate will be far below the level needed for sustained economic recovery. Although President Mobutu is in a stronger political position than ever, we believe public discontent with declining living standards will lead to growing opposition to his rule.

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Dim Export Picture

We estimate that export earnings, which account for most of the country's foreign exchange and government revenues, will drop more than 8 percent this year—to about $140 million—because of falling or stagnant world prices for major exports. In 1984, increased import demand in the industrialized countries and a large currency devaluation helped boost exports 23 percent, but this year's slow growth among OECD nations and high existing stocks of goods has reduced trade between Kinshasa and its principal economic partners.[1] Petroleum exports, largely responsible for the improved export picture in 1984, are likely to be about $100 million lower than anticipated this year because of persistent production problems and declining world prices. Falling prices for diamonds, zinc, and coffee probably will reduce earnings by another $35 million. Copper revenues—accounting for 45 percent of the total—are likely to meet projections due to a slight rise in the world price and no serious production problems. Cobalt, another important mineral export, is also experiencing market problems, and we estimate that the world price will rise only 8 percent this year, compared to a 68-percent jump in 1984.

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Table 1
Zaire: Exports to the OECD, First Half 1984 and 1985

Million US $ (except where noted)

	1984	1985	Change *(percent)*
Exports by country [a]			
Total	756	719 [b]	−5
Of which:			
United States	233	185	−21
Belgium	253	221 [b]	−13
West Germany	91	104	14
France	57	50	−12
Japan	36	29	−19
United Kingdom	7	9	29
Exports by commodity group [c]			
Foodstuffs	52	65	25
Raw materials	205	167	−19
Fuels	151	143	−5
Manufactures	194	154	−21
Other	77	82	6

[a] Based on partner country import data.
[b] Estimated.
[c] Due to data limitations numbers are based on partner country import data from the United States, Belgium, France, Japan, West Germany, and the United Kingdom.

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Although export growth probably will resume next year, we believe prospects for a rapid rise in earnings over the medium term are poor. We believe the likely depreciation of the dollar against major industrial

[1] Exports to the OECD, which account for 90 percent of total Zairian exports, dropped 5 percent in the first half of 1985 compared to the same period last year. Sales to the United States, Belgium, France, and Japan—Zaire's major trading partner—fell, while exports to West Germany and the United Kingdom increased. Exports of foodstuffs (mostly coffee) rose in the first six months of this year, while sales of raw materials (primarily copper) and manufactured goods declined.

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country currencies and the stabilization of oil prices after 1986 will help Zaire achieve real (inflation-adjusted) export gains averaging just over 5 percent per year through 1990. Constraints exist within each major export industry, however, that will limit future export gains:

- *Copper.* Given the existing capital stock, copper production is now near capacity and little scope exists for further increases without major new investment. In addition, we estimate that copper prices are likely to increase only slowly throughout the rest of the decade.

- *Cobalt.* Demand for cobalt is closely tied to economic activity in industrialized countries, and with only moderate developed country growth expected, price gains are likely to be modest. Zaire is already the dominant cobalt producer—accounting for nearly half of world production—so prospects for increasing market share are limited.

- *Diamonds.* Zaire is the world's largest producer of industrial diamonds, and diamond production has risen sharply since the authorities instituted a preferential exchange rate and pricing policy for the diamond industry in 1983. A diamond glut currently exists, however, and prices and production are likely to be weak in the near term until the oversupply is eliminated.

- *Coffee.* Although production has recently increased because of good weather and improved incentives resulting from the economic reform program, prospects for additional export revenues are poor. Coffee earnings are constrained by export quotas fixed by the International Coffee Organization and the poor quality of Zaire's coffee.

- *Oil.* Despite private forecasts of a 27-percent growth in export volume the rest of the decade—30,000 b/d to 38,000 b/d—the increase will be small in absolute terms, resulting in less than $60 million in additional revenues.

- *Manufacturing.* Zaire is not in a position to significantly increase noncommodity exports. Manufacturing industries are scarce, and the industrial sector is not likely to undergo substantial development given the country's tenuous financial position. 25X1

Growing Debt Burden

Servicing the $5 billion debt is a key obstacle to growth because it is absorbing an increasing share of the country's scarce foreign exchange. According to the US Embassy, debt repayments in 1985 will total close to 25 percent of export earnings and about 55 percent of government revenues, despite the rescheduling of some $305 million in public and publicly guaranteed debt falling due between January 1985 and March 1986—the sixth Paris Club rescheduling since 1976. Past reschedulings have capitalized interest payments and delayed amortization of principal, sharply raising Zaire's long-term debt profile and making new reschedulings all the more painful. 25X1

Nevertheless, we see little alternative to continued annual reschedulings of principal and interest payments. Without them, debt service ratios would range from 55 to 60 percent compared to 20 to 25 percent with reschedulings. In our view, Zaire desperately needs a comprehensive multiyear rescheduling, but this is unlikely given current lender attitudes. Under these assumptions we expect debt service payments to decline slightly over the next two years, then rise sharply near the end of the decade as grace periods expire and more principal becomes due. Debt service will total about $440 million this year, rising to $550 million by 1990. Total foreign debt will continue to rise sharply over the period; we calculate that capitalization of interest alone will add nearly $1.5 billion to total debt by 1990. 25X1

Limited Outside Capital

External sources of funds are likely to be limited in the foreseeable future. Although donors have responded to Kinshasa's reform efforts with additional bilateral aid over the past three years—including balance-of-payments support—we judge their own budget constraints make it unlikely that these donors will increase aid sufficiently to fuel a recovery. According to World Bank statistics, Kinshasa paid out over $190 million more last year to

Table 2
Zaire: Projected Growth of Import Capacity Under Alternative Scenarios [a]

Billion US $

	1984	1985	1986	1987	1988	1989	1990
Baseline export growth							
Exports	1.77	1.63	1.67	1.77	1.89	2.01	2.12
Plus gross borrowing	0.88	0.75	0.73	0.72	0.77	0.87	0.86
Plus other services balance	−0.68	−0.82	−0.82	−0.82	−0.82	−0.82	−0.82
Less debt service [b]	0.65	0.44	0.42	0.41	0.46	0.56	0.55
Less change in foreign exchange reserves	0.16	0	0	0	0	0	0
Balance (import capacity)	1.16	1.12	1.16	1.26	1.38	1.50	1.61
Change in import capacity *(percent over previous year)*		−3.4	3.6	8.6	9.5	8.7	7.3
Recession scenario [c]							
Exports	1.77	1.63	1.66	1.72	1.80	1.90	1.99
Plus gross borrowing	0.88	0.75	0.73	0.72	0.77	0.87	0.86
Plus other services	−0.68	−0.82	−0.82	−0.82	−0.82	−0.82	−0.82
Less debt service	0.65	0.44	0.42	0.41	0.46	0.56	0.55
Less change in foreign exchange reserves	0.16	0	0	0	0	0	0
Balance (import capacity)	1.16	1.12	1.15	1.21	1.29	1.39	1.48
Change in import capacity *(percent over previous year)*		−3.4	2.7	5.2	6.6	7.8	6.5

Note: The following is a summary of the findings in Table 2:

Percent per year

	Exports		Import Capacity	
	Nominal	Real	Nominal	Real
Baseline	5.4	4.5	7.5	1.9
Recession scenario [c]	4.1	3.2	5.7	0.2

[a] To assess the probable impact of projected exports, debt servicing, and new credit availability on import capacity and economic recovery, we derived a methodology (table 2) that linked our expectations for export growth, our figures for debt service payments, our estimate of the services balance (excluding interest payments), an assumption that the level of new credit extended to Zaire remains constant at the 1985 level, and an assumption that foreign exchange reserves remain unchanged at this year's level. We then used these estimates of import capacity to assess the potential for economic growth.

[b] Debt service figures include short-term payments.

[c] Unlike the baseline scenario which assumes 3-percent growth per year in the OECD countries, the recession scenario assumes an OECD recession. Since Zaire ships over 90 percent of its exports to the OECD, a drop in OECD real income growth, such as occurred in 1982-83, would reduce export gains, leaving Zaire with less foreign exchange to meet debt service payments and boost import growth. To quantify the impact of a recession in developed countries on Zaire's exports, we altered the baseline scenario so that OECD real GNP growth falls to 1.5 percent in 1986 and −1 percent in 1987, recovering to 1.5 percent in 1988 and 3 percent per year thereafter.

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Table 3
Zaire: Scheduled Debt Service Payments, 1985-90

Million US $

	Scheduled Principal Repayments		Interest Payments	Total Scheduled Debt Service
	Long Term	Short Term		
1985	441	310	334	1,085
1986	423	300	304	1,027
1987	411	310	274	995
1988	462	330	243	1,035
1989	474	320	213	1,007
1990	380	330	175	885

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Table 4
Zaire Debt Service Payments With Rescheduling,1986-90 [a]

Million US $

	Principal Repayments			Interest Payments	Total Debt Service
	On Previously Capitalized Interest	Scheduled Long Term	Short Term		
1985	0	441	0	0	441
1986	0	423	0	0	423
1987	0	411	0	0	411
1988	0	462	0	0	462
1989	33	474	51	0	558
1990	69	380	101	0	550

[a] Using table 3 figures as a base, we assumed that Zaire would continue to obtain annual rescheduling of principal and interest. To take rescheduling into account, we made the following assumptions: all scheduled interest payments are capitalized; all scheduled short-term debt is repaid with a six-year maturity with a four-year grace period; all long-term principal is repaid as scheduled; capitalized interest is repaid with a 10-year maturity with a four-year grace period. These terms are similar to those contained in previous reschedulings, although greatly simplified for ease of analysis. These numbers do not include payments on any new debt incurred after 1984, excluding capitalized interest which totals nearly $1.5 billion by 1990. Should any new borrowing occur, the debt service figures will understate the actual level of debt service for the 1985-90 period. The results are not to be taken as definitive, but as a guide to the impact of future rescheduling on debt service payments. Further information on the computation on debt service payments can be obtained from the author.

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medium- and long-term creditors than it received in new funds. Aside from continued capitalization of interest payments, which increases lender exposure, we believe little new credit will be available over the medium term. With creditors becoming more reluctant to commit new funds to LDC debtors, we believe future new lending is likely to be concentrated in the larger debt-troubled nations with reasonable prospects for repayments, such as Brazil, rather than in smaller, higher risk countries like Zaire. Finally, despite an improved climate for foreign businesses—profits and dividends are being remitted for the first time since the mid-1970s—investors remain deterred by the country's weak infrastructure and past history of economic mismanagment. [redacted]

Stagnant Import Capacity

Foreign exchange shortages caused by declining exports, growing debt obligations, and lack of foreign reserves have forced Kinshasa to cut back on essential imports, thereby slowing economic activity. We estimate that imports will fall 3 percent this year, compared with a 7-percent increase last year, while real GNP growth will slow to about 2 percent this year, compared with last year's 2.6-percent pace. [redacted]

We estimate that Zaire faces long-term import restraint, with real import growth averaging only about 2 percent per year through 1990, not nearly enough to fuel an economic recovery. Slow export growth, continued high debt service payments, and the large service account deficit will be the main factors contributing to the low import growth. With foreign exchange reserves nearly depleted and the prospects of little new credit, Zaire has little means to further expand import capacity. Given these import constraints, we believe Zaire faces the prospect of continued slow economic growth. Real income gains are likely to average about 1 percent per year over the 1986-90 period, far below the level needed for sustained economic growth.[2] With population growth at nearly 3 percent per year, the slow pace of economic growth also implies continuation of the decadelong decline in per capita real GNP. [redacted] 25X1

Political Implications

We believe Mobutu's principal political challenge over the next five years will be to prevent growing public discontent with declining living standards from eroding his authority. Mobutu's strong political position has allowed him to implement harsh austerity measures with little public protest so far, but we believe opposition to the IMF program simmers beneath the surface and continued austerity may lead to small-scale labor and urban disturbances, as well as increased political opposition to Mobutu within the ruling party. In our view, if he decides that popular disaffection has risen to dangerous levels and he foresees no prospect for a quick change in the economic picture, he may choose to abandon the IMF program and declare a unilateral moratorium on some portion of Zaire's debt. This would free up resources that could be spent on higher wages, public investment, social welfare, and increased liquidity for the private sector—all of which would have immediate political benefits. Although Mobutu would understand the long-run costs of abandoning the IMF, this would be outweighed by short-term political considerations, anger at the IMF and Western donors for their lack of support, and the realization that continuing the IMF program does not guarantee sustained economic growth. [redacted]

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[2] To predict the pace of future real income gains, we made use of the relationship between real imports and real income. Most LDCs—Zaire included—are strongly dependent on imports to fuel consumption and investment. The ratio of imports to real GNP reached a 10-year low in Zaire in 1981 and has not recovered to previous levels. Given the strong dependence of Zaire on imports, and the need to restore the import/GNP ratio to past levels, we believe real imports will need to rise rapidly—perhaps twice as fast as real income—to ensure sustained economic growth. [redacted]

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Kenya: Economy at the Crossroads

Kenya faces economic problems that, if unresolved, could undermine the country's position as one of the few open and relatively successful economies on the continent. A ponderous government bureaucracy, runaway population growth, deteriorating balance-of-payments position, and vulnerable export markets pose serious obstacles to development. In our view, Kenya can no longer afford merely to continue making relatively minor adjustments to the policies that have served it well in the past, and government planners will be required to implement new initiatives to cope with a changing economic environment and to increase growth.

Economic performance over the past few years has been mixed, but prospects for improvement over the near term under the current government strategy are not bright. Kenya's real gross domestic product increased by only 0.5 percent in 1984, down from 3.9 percent in 1983. The population growth rate—the world's highest—was 4.2 percent in 1984, or 8.4 times the growth of the economy. Although GDP is expected to grow by 4 percent in 1985, Kenya is saddled with an urban unemployment rate exceeding 12 percent, a debt service ratio of approximately 30 percent, and sufficient hard currency for less than three months of imports.

Background to Declining Growth

After the remarkable economic successes in the first decade following independence, a series of international events, together with significant structural problems, have combined since the 1970s to undermine prior gains. Major droughts, increases in the price of imported petroleum, the collapse of the East African Community (the major market for Kenyan-manufactured goods), global recession, and high international interest rates have resulted in a steady tightening of the foreign exchange constraint on growth, while volatility in the prices of Kenya's key exports, coffee and tea, has compounded already difficult problems of economic management.

The First Decade of Independence: Solid Economic Growth

Kenya inherited a mixed economy with a strong private sector from its British colonial rulers. After achieving independence in 1963, the government embarked on a strategy of rapid economic growth by means of public investment, encouragement of both smallholder and large-scale farming, and promotion of accelerated industrialization with incentives for private—including foreign—investment in modern industry. This paid off in significant domestic growth and structural transformation. Total GDP grew at an average annual rate of 6.6 percent during the period 1964-73. The agricultural sector, stimulated by redistribution of large estates to smallholders, rapid diffusion of improved inputs, and growth of smallholder output, grew at 4.7 percent per annum. Manufacturing expanded at 8.4 percent annually, due to growing domestic demand created by rising agricultural incomes, high levels of protectionism, a liberal attitude toward foreign investment, and active government promotion of—and participation in—manufacturing ventures. To a lesser extent, manufacturers exported goods to neighboring countries, particularly Tanzania and Uganda, partners with Kenya in the protected East African Community. Finally, Kenya's careful economic management yielded a strong fiscal performance, low rates of inflation, and manageable current account deficits through the early 1970s.

According to US Embassy reporting, the government has not responded to changing external conditions with effective policies. We believe its failure to adapt to the new circumstances has increased the country's vulnerability to external shocks and contributed to the deceleration of growth. Pervasive public-sector participation in the economy, declining agricultural production, deteriorating international terms of trade and unfavorable balance-of-payments trends, import-substitution industrialization behind high protective barriers, and the population growth rate are preventing the economy from generating per capita growth.

Agriculture: A Troubled Sector

Kenya's vital agricultural sector is in deep trouble. Agriculture provides more than two-thirds of Kenya's exports and contributes a 30-percent share of GDP; about 85 percent of the country's population depends on agriculture for their livelihood. Agricultural growth has slowed considerably, from a 4.6-percent-per-annum growth rate during the eight years following independence to an average of about 2.7 percent from 1972 until 1979. Total output from the agricultural sector declined by 2.9 percent in 1984 compared to 1983.

Adverse weather conditions also have contributed to Kenya's declining agricultural production. In 1984, the lack of rain in Kenya's principal producing areas led to the worst drought in the country's history. The IMF estimates that grain output fell by about 40 percent below normal levels, requiring Kenya to import about 600,000 metric tons of maize, 322,000 metric tons of wheat, and significant quantities of other foodstuffs. Coffee, sisal, and sugarcane showed modest increases, with most other agricultural commodities registering declines. The situation was only partially alleviated by a doubling of the world market price for tea and a 10-percent improvement in the export price of coffee in 1984.

Although Kenya has emerged successfully from the drought in 1985, as adequate rain throughout most of the country has contributed to favorable crop yields, serious long-term problems remain unresolved. The relentless growth in population is outstripping the ability of farmers to increase food production. The small proportion of arable land has exceeded its carrying capacity, forcing growing numbers to cultivate marginal lands and making productivity gains more difficult to achieve. Agricultural productivity has been further eroded by disincentives to farmers resulting from government regulation of prices. Despite a recent improvement in agricultural commodity prices, the agricultural-sector terms of trade declined by 3.8 percent in 1984, compared to a 1.9-percent drop in 1983. According to the US Embassy, actual receipts by farmers are generally between 75 and 85 percent of the free market price. In spite of government promises to reduce the number of commodities that are price controlled, progress to date has been slow.

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Sluggish Manufacturing Performance

Protectionism and import substitution in the post-independence years have not prepared the manufacturing sector for competition in current markets. Comprising approximately 11 percent of GDP with a growth rate of about 4 percent in 1984, Kenyan industrial output has slowed considerably compared to the 10-percent average growth rate of the 1970s. The collapse of the protected East African Community in 1978, with the ensuing closure of neighboring countries' borders, and attempts by the government to liberalize trade have narrowed the scope for marketing manufactured goods, increasing unutilized capacity and delaying additional investments. Kenya's declining terms of trade have considerably limited the country's import capacity and hence the supply of essential foreign inputs for industrial production. Although Kenya is making efforts to improve the efficiency and competitiveness of its manufacturing sector, industry remains hobbled by stifling protectionist measures, cumbersome import/export regulations, and corruption.

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Inhibiting Role of the Public Sector

The government's role in the economy is overly intrusive and often counterproductive, in our judgment. The government controls the prices of basic producer and consumer goods, bank rates, foreign exchange rates, and minimum wages. The US Embassy reports that the huge, inefficient, and costly bureaucracy fetters the marketplace with over-regulation and corruption, reducing incentives to investors and primary producers. Kenya operates a vast network of parastatal organizations: apart from the statutory boards there are 47 wholly owned enterprises and more than 100 companies with

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majority or minority government ownership. While some of these public enterprises have made profits, many have made significant losses, with the cumulative effect of a net fiscal drain and the diversion of scarce resources away from more productive uses. Although substantial progress has been recorded in reducing the overall budget deficit in the last few years, additional actions will be required in the 1985/86 budget. According to the IMF, such adjustments should bring the overall budget deficit to under 4 percent of GDP, down from approximately 10 percent in 1980. [redacted]

Balance-of-Payments Difficulties

Kenya's vulnerability to fluctuations in commodity prices, combined with the recent drought, have generated a worsening balance-of-payments situation. Although Kenya recorded a positive overall balance of payments in 1984, when unanticipated high coffee and tea prices offset the costs of drought-related food imports, the outlook for 1985 and 1986 is precarious. A combination of high import levels, less buoyant coffee and tea earnings, "off-budget" foreign exchange commitments for airline and patrol boat programs, and a slower rate of disbursal from aid donors will reduce foreign exchange holdings. The central bank and treasury project a 20-percent fall in coffee prices and a 34- percent drop in tea prices this year. Coffee earnings will remain further constrained by Kenya's modest International Coffee Organization export quota which stands at two-thirds of its production. As a result of reduced coffee and tea prices, the Kenyans have revised upward their projection of the current account deficit for 1985 by 25 percent. [redacted] at the end of October, Kenya's foreign exchange reserves stood at $320 million, the lowest level in two years, just enough to cover less than three months of imports. Thus far, there has been no increase in government grants from donors. Tourism earnings also are not expected to improve unless there is a new appreciation of the US dollar. Unless Kenya's export sector improves drastically, balance-of-payments difficulties will continue for the next several years. [redacted]

IMF Gains

Kenya's implementation of selected IMF-recommended adjustments and its integration of the private sector into its development strategy stand in stark contrast to the policies of most of its radical African sister states. Having successfully negotiated several standby agreements, Kenya stands as one of the IMF's prize pupils in Africa. Despite the trauma of the 1984 drought, the limited IMF-sponsored adjustments have resulted in the tenuous fiscal and monetary equilibrium that has been maintained to date. Under the Fund's auspices, Kenya has made strides in liberalizing the trade regime, slowing fiscal expansion, depreciating the Kenyan shilling, and enacting several other reforms. [redacted] 25X1

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According to the US Embassy, however, some observers feel the IMF is pulling its punches on more fundamental reforms for fear of damaging its present positive relationship with Nairobi. We believe the generally optimistic outlook held by the IMF has served both to postpone needed policy adjustments and to limit the bilateral aid that a more pessimistic assessment of Kenya's economic health would elicit from donor countries. [redacted] 25X1

Economic Outlook: Hard Choices

The coming years will be crucial ones for Kenya's economy. The combination of several years of external shocks to the economy and lack of adequate policy responses have led to growing economic tensions. Although increased export prices helped to ameliorate the impact of the 1984 drought, Kenya, in our view, cannot reliably depend on the volatile commodity market to raise domestic growth. The current abundant food situation masks a sharp deterioration in the terms of trade for its chief resources, coffee and tea. [redacted] 25X1

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Unless the Moi government can use its present window of opportunity before another drought to enact the arduous reforms necessary to encourage growth, we believe Kenya's past achievements will be undermined. In our view, prerequisites to better per capita growth performance include the dismantling of policies that retard agricultural growth, instituting aggressive budgetary and anticorruption measures, rationalizing parastatals, and reducing the rate of population growth. Unless decisive action is taken on these and other fronts, it will be difficult for Kenya to generate sustained economic growth. [redacted] 25X1

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The government acknowledges the need to act on the host of hard choices to effect structural change. It wants the resources that are available from its bilateral and multilateral donors, but finds the broad policy prescriptions that accompany the dialogue with donors unpalatable. We believe that the government's desire to limit the presence and influence of private corporations, the role of tribal patronage in economic decision making, and the general government desire to be in control will limit President Moi's willingness to enact the major initiatives necessary to invigorate the economy. 25X1

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Ethiopia: Collectivization Programs

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Addis Ababa is pushing forward with its ambitious—and probably ill-fated—efforts to collectivize agriculture through massive population relocation by resuming its controversial resettlement program and launching a new "villagization" scheme. In our view, Ethiopia's Marxist leader Mengistu intends to tighten his political and physical control of the peasants by placing them, usually against their will, on collective farms often hundreds of miles from their original homes. Mengistu's determination to collectivize agriculture, in our judgment, will undercut prospects for agricultural growth and increase Ethiopia's dependence on Western food aid.

Regime's Collectivist Goals

Mengistu regards the collectivization of agriculture as an essential feature of Ethiopia's continuing revolution, and has publicly advocated collectivization since the early days of the revolution. The military government, in an attempt to rally peasant support for the revolution, nationalized all land in 1975 and immediately enacted various measures transferring land from absentee landlords to peasants actually cultivating it.

The regime then organized peasant associations to implement the reforms and act as de facto local governments. Eventually, however, the power of the peasant associations grew, posing an obstacle to the regime's effort to impose socialist measures in the countryside. In an initial attempt to break their power and to tighten government control of agriculture, the regime introduced its collectivization program in 1979. The regime's current 10-year plan aims to have 53 percent of all farmers working on collective farms by 1993. The effort to collectivize agriculture, however, has failed dismally, and we believe the government's goal is unrealistic because of general peasant resistance to losing their farms. The northern Ethiopian peasant, in particular, is strongly individualistic and disinclined toward any collective organization.

Over the past 20 years, agriculture's contribution to the gross domestic product has steadily declined despite Ethiopia's vast agricultural potential. According to US Embassy reporting, only 3.5 percent of the land currently under cultivation is being farmed by collectives and, according to the World Bank, farm output has grown less than 1 percent since 1970, compared with over 2 percent yearly in the previous decade. Ethiopia remains a food-deficit country and only Western assistance has prevented massive starvation during periods of drought. 25X1

Resettlement

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The resettlement program was suspended for about three months this fall due to temporary logistic problems, but is now back in full swing.[1] Mengistu plans to move, with Soviet logistic support, a total 1.2 million of Ethiopia's estimated 42 million people from the drought and insurgency-stricken northern provinces to the more fertile lands in the south and southwest of Ethiopia by the end of 1986. Upward of 500,000 peasants have been resettled since October 1984, when the program was launched in earnest at the onset of the current drought crisis. 25X1

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The government, which promotes resettlement as a way to break the cycle of drought and famine in the north, has run into the same problems it encountered with an unsuccessful resettlement program during the 1978-79 drought. Almost all of the resettlement camps lack the necessary infrastructure, are poorly organized, and are without leadership. According to US Embassy reporting, the camps do not fulfill even the most basic human needs and, at least in some camps, the resettlers are prevented from leaving by

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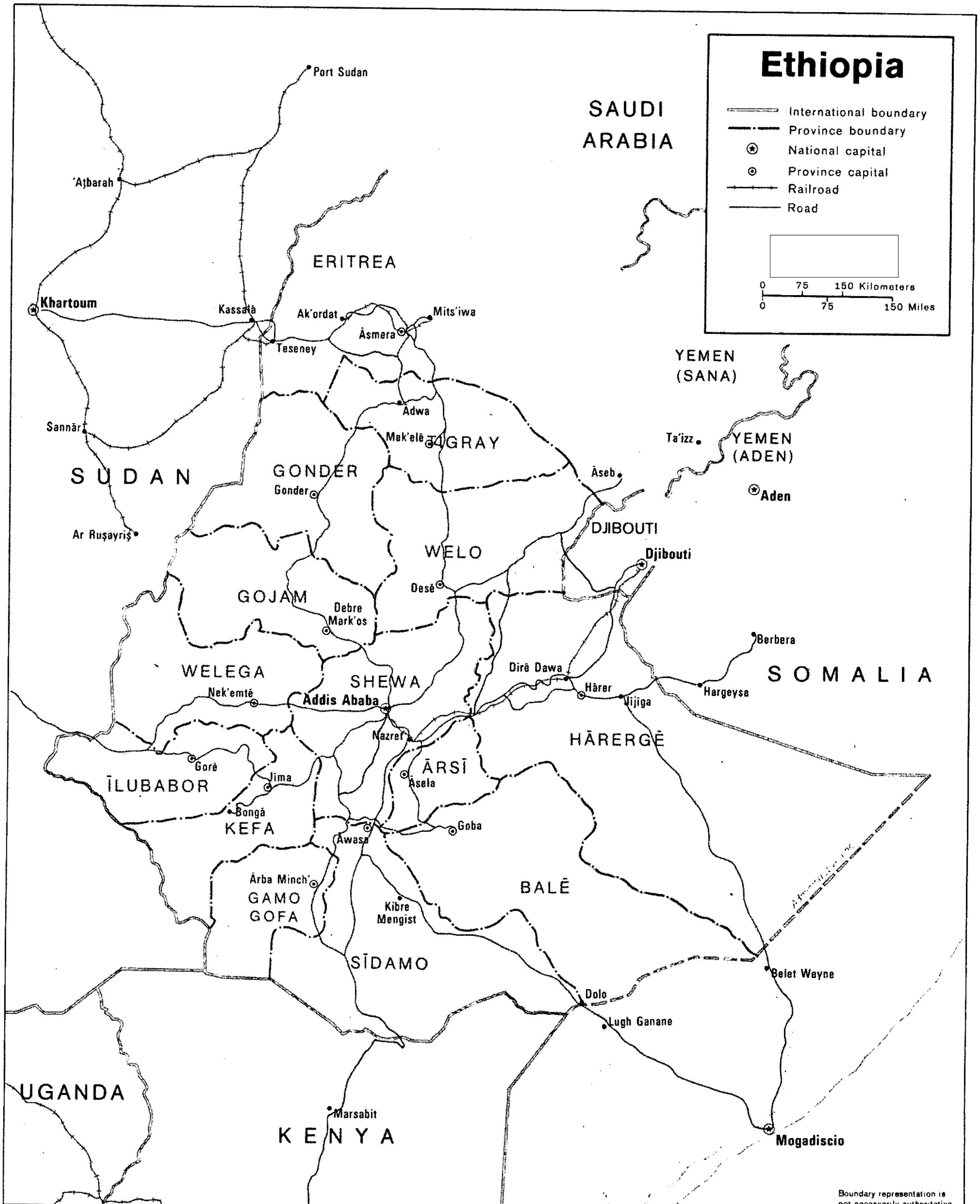

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party cadre armed with automatic rifles. In mid-November, the Ethiopian Government began commandeering trucks from Western relief agencies to transport refugees. The famine refugees, however, are resisting resettlement. For example, in October, thousands of refugees fled into the foothills at Korem Camp in Wollo Province to escape a resettlement roundup by the ruling party cadre.

Villagization

Addis Ababa's villagization program, a relatively new feature of the collectivization drive, forces peasants to destroy their traditional homes scattered about the countryside and move to newly constructed central villages. Chairman Mengistu announced the program in September.

The villagization program has not received the same fanfare as Mengistu's resettlement program, and requests by Westerners to visit the new villages have usually been denied. The government contends that villagization allows for better delivery of social services such as education and medical care. We believe, however, that the program's primary goals are increased control over the rural population and faster collectivization of agriculture.

Outlook

The past performance of Ethiopia's collective farms suggests that the current collectivization effort will only cause agricultural production to stagnate further, in our view. We also believe that the government will continue to encounter passive resistance as a steady trickle of resettled peasants continues to make the long trek back to their traditional homes in the north. In addition, the government's increasingly rigid measures to implement collectivization will result in the forcible relocation of many peasants and continued widespread human rights violations.

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Namibia: SWAPO in Disarray [redacted] 25X1

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The South-West Africa People's Organization (SWAPO) has recently displayed increased signs of disorganization and low morale, as well as a growing concern that the interim government in Namibia will sidetrack the United Nations' plan for independence. The inability of SWAPO to gain a foothold in Namibia, tribal conflicts among SWAPO leaders, and growing impatience over the failure of international negotiations for Namibia's independence have all eroded the insurgents' morale. SWAPO also reportedly is worried that unrest in South Africa has deflected the concern of the international community away from the Namibian issue. Nevertheless, the organization still has strong grassroots support within Namibia, especially in Ovamboland, although growing internal conflicts could diminish its viability as a political force in an independent Namibia. [redacted]

Eroding Support

Rivalry between the dominant Ovambo tribe, whose members hold over three-fourths of the top leadership positions, and the various minority tribes has long been a problem for SWAPO. The Ovambos have purged Nama and Damara tribesmen in the past [redacted]

[redacted]

Morale among SWAPO members in Lusaka, particularly non-Ovambo, reportedly has declined recently. [redacted]

[redacted]

SWAPO's foreign backers, including the USSR, Cuba, the OAU, and Zambia, appear increasingly concerned with the organization's internal problems. [redacted] Havana has cited lack of leadership and tribalism as factors affecting SWAPO's dedication to armed struggle. [redacted] 25X1

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[redacted] Nujoma's announcement at the Nonaligned Movement summit in Luanda that SWAPO would intensify its armed struggle against Namibia was probably intended to bolster sagging morale within the organization and to reassure foreign backers. Nujoma's tour in December of several West African states, including Nigeria and Ghana, was probably an effort to garner support. Although press reports indicate that he received a warm reception, no tangible aid was forthcoming from any country. [redacted] 25X1

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SWAPO probably hopes that more military activity might allow it to recover lost prestige. [redacted] 25X1

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[redacted] Press reports of 25X1

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attacks, and seizures of small-arms caches within Namibia, confirm SWAPO's commitment to continuing the armed struggle. [redacted] 25X1

Outlook

This year's rainy-season offensive, which was probably delayed in part because of a lack of rain in early November, is unlikely to be any more successful than in previous years. During last year's offensive, South African forces successfully intercepted SWAPO guerrilla units just inside Namibia and captured an entire SWAPO special unit in the Kavango region of northern Namibia. Nevertheless, SWAPO probably will continue to conduct low-level terrorist attacks, particularly against white farmers, in northern Namibia. The unpopular practice of abducting Namibian villagers to fill guerrilla ranks also is likely to continue. [redacted] 25X1

SWAPO's internal problems are unlikely to be solved in the near term. The organization's continued military impotence and the deadlocked negotiations for Namibian independence based on UN Resolution 435 have put SWAPO effectively on the sidelines with little chance of making enough political or military headway to buttress sagging morale. [redacted] 25X1

[redacted] 25X1

Zimbabwe-USSR: Mugabe's Cautious Approach [redacted] 25X1

Prime Minister Mugabe's first official visit to Moscow earlier this month was undertaken primarily to demonstrate his nonalignment. We do not expect relations between the two countries to become significantly closer, largely because Harare sees little advantage to be gained. Relations have been cool since Mugabe became Zimbabwe's first Prime Minister in 1980 following 15 years of armed struggle against the country's white minority government. The USSR provided military support for Joshua Nkomo, Mugabe's rival during the war, and Mugabe believes the Soviets remain committed to Nkomo. While the Soviets would like to broaden relations, Moscow is not willing to make substantial economic or military commitments unless Mugabe agrees to closer political ties. [redacted]

Mugabe's Visit to Moscow

In our view, Mugabe's visit to Moscow probably was intended to underscore Zimbabwe's nonaligned status and balance recent official visits to the United States and China. The Zimbabwean leader is scheduled to assume chairmanship of the Nonaligned Movement (NAM) next year. [redacted]

The US Embassy in Moscow believes that Mugabe's visit broke little new ground in bilateral relations, although it did pave the way for closer ties if both countries decide to pursue them in the future. Mugabe briefly met with Soviet leader Gorbachev and signed agreements on economic and technical cooperation and a protocol on party-to-party cooperation. The protocol formalizes previous low-level party contacts, while the economic agreement appears to be a standard framework for discussion of possible future cooperation. According to Mugabe, military aid was discussed in general terms but no agreements reached. [redacted]

The View From Harare

Largely because of Mugabe's long-held suspicions, relations between the two countries have developed little since independence. As the next NAM chairman, we doubt that Mugabe will want to draw too close to the USSR, thereby jeopardizing his nonaligned credentials. Mugabe made a brief unofficial visit to the USSR in September during a stopover from North Korea, according to TASS, but no agreements were reported. A military delegation also traveled to Moscow in August, [redacted] but received a cool reception from the Soviets. [redacted] 25X1 the Soviets offered the delegation only vintage arms. 25X1 There is little trade between the two countries, according to the resident Soviet Ambassador, and officials at Zimbabwe's Ministry of Foreign Affairs are hard pressed to list any areas where trade could profitably be expanded, according to the US Embassy. Other Embassy sources report that 25X1 Zimbabwe doubts the Soviets can supply the consumer goods it needs, and fears that the USSR is only interested in dumping substandard goods into the Zimbabwean economy. [redacted] 25X1

The View From Moscow

Moscow has long been interested in improved relations with Zimbabwe, and its ultimate goal is to 25X1 bring the two countries closer together politically. Mugabe's rather distant treatment of the Soviets in the past, however, has made them wary of pushing closer relations too quickly with Harare. Moscow probably wants to avoid being "used" by Mugabe while getting little in return. Nevertheless, with Zimbabwe's relatively strong economy, its membership in the Frontline States, and its proximity to South Africa, the country is an important player in regional affairs that the Soviets feel they cannot ignore. Furthermore, with Mugabe acting as chairman of the NAM for the next two years, Zimbabwe could play a more important role internationally, especially on southern Africa issues. 25X1
[redacted] 25X1

According to the US Embassy, the Soviet Ministry of Foreign Affairs has said Moscow wants to expand trade and cultural relations, including opening an Aeroflot office in Harare. The Soviets would like to increase exports of machinery and equipment, and imports of Zimbabwean raw materials and foodstuffs. Moscow also hopes to expand educational ties; the US Embassy estimates that there are currently more than 100 Zimbabwean students studying in the USSR. 25X1
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Outlook
We believe that improvement in relations will be a long process with each side being very sensitive to the moves the other makes. While there may be some increase in delegation visits between the two countries, we believe Mugabe is still skeptical of Moscow's intentions. For their part, the Soviets are unlikely to be able to warm the relationship too quickly after so many years of cool treatment from Mugabe, in our view. The Soviets, however, probably will be alert over the longer run for opportunities to promote closer political ties. If, for example, Zimbabwe were to become bogged down in a major and unending military commitment to Mozambique, Mugabe might be forced to turn to the Soviets for major arms aid if needed assistance could not be obtained elsewhere. 25X1

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Togo: Implications of the Bombings 25X1

President Eyadema is likely to ask the French Government to clamp down on Paris-based Togolese exile groups, following the renewal of bombings in Lome in early December, according to the US Embassy. The bombings were probably carried out by internally based dissidents with external assistance. Although French President Mitterrand was a close friend of former President Olympio, who was overthrown in 1963 by Eyadema and whose sons head an exile group, Paris has maintained close ties to the staunchly conservative Togolese Government. In 1984, France provided some $42 million in economic aid and is Togo's largest trading partner. According to the US Embassy in Paris, the Mitterrand administration has told Togo that it is unwilling to arrest and extradite French-based dissidents, but will monitor their activities.

President Eyadema 25X1

The Paris-based opposition groups are the Movement for Democracy in Togo (MTD), headed by Gilchrist Olympio, and the National Liberation Front of Togo (FNLT), led by two former Army officers. According to press reports, Eyadema has accused the MTD of attempting to assassinate him, and blamed it for a foiled mercenary plot in 1977 and an alleged coup plot in January 1983. The exiles occasionally have smuggled anti-Eyadema literature into Togo from neighboring Ghana, but we have no evidence of either popular or military support for them, and believe they pose little threat to the President.

The spate of bombings since August may reflect growing popular discontent with rising unemployment among Lome's youth and deep-seated tribal frictions. According to the US Embassy, about 80 percent of university graduates have been unable to find work since 1983. Although Eyadema has sought to ease ethnic tensions by distributing development projects among regions and bringing southerners into his administration, southerners still resent the control of his northern Kabre tribe over key government, military, and security posts. No southerner commands a key military unit and, according to the US Embassy, Army garrisons in the capital are composed largely of Kabre tribesmen. 25X1

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The US Embassy reports that Libya has long sought to cultivate Togolese students and probably has provided them with financial aid. Eyadema believes he is on Qadhafi's "hit list" because of his strong ties to the West and his criticism of Libyan involvement in Chad, according to Embassy sources. 25X1

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Africa Brief

Somalia

Siad Tries To Reactivate Dissidents [redacted] 25X1

[redacted] President Siad is attempting to revitalize the dissident Western Somali Liberation Front (WSLF)—Somalia's primary weapon for pressing its irredentist aspirations in the Ogaden region of Ethiopia. [redacted] 25X1 25X1

[redacted] The US Embassy reports that Siad convened a leadership meeting of the WSLF and other Ethiopian dissident organizations in Mogadishu in late November, an occasion we believe he probably used to exhort them to break the border stalemate with Ethiopia. [redacted] 25X1 25X1

While Siad's attempts to reactivate the WSLF may cause a temporary increase in cross-border military activity, we believe the WSLF lacks the capability to mount more than occasional harassing attacks on Ethiopian forces. The dissidents' military strength is undercut by chronic tribal squabbling and leadership disputes, and any intervention by Mogadishu to quell the infighting would only make matters worse, in our view. In any case, the WSLF—whose strength we estimate has fallen to some 1,000 fighters—is no match for the well-equipped Ethiopian Army units stationed in the Ogaden, and Somalia lacks the resources to change the status quo significantly. [redacted] 25X1